No. 85-1736

In The

Supreme Court of the United States

October Term, 1986

JERSEY SHORE STATE BANK,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF FOR PETITIONER

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I. NOTICE IS REQUIRED TO BE GIVEN TO EACH PERSON LIABLE FOR THE TAX PURSUANT TO SECTION 6303(a).

A. The mandate of Section 6303(a) must be followed.

The breadth of the Government's argument with regard to the non-applicability of Section 6303(a) is seen in the manner it attempts to eliminate the notice requirement of Section 6303(a) from the Code in total.[1] The Government argues that not only does it not have an obligation to provide notice of an assessment to a third party lender, but that it has no liability for providing *any* notice of assessment even to the employer in order to have the benefit of the extended statute of limitations to collect the tax. The Government notes: "Once a timely assessment is made against the employer, in other words, Section 6502(a) gives the government six years to bring a collection suit against the employer, even if the government for some reason failed to give notice of the assessment to him. A fortiori, the government has the same six years to bring suit against a third-party lender irrespective of whether the lender received a copy of that notice." (Res. Br. 43).

The position of the Government appears to be that there is no notice requirement in the Code to anyone in order for the statute of limitations to be extended for an additional six years once assessment has been made against the employer within three years after the tax return has been filed. Such an interpretation, directly contradicts the plain language of Section 6303(a) with regard to notice.

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[1]Statutory references are to sections of the Internal Revenue Code of 1954 (26 U.S.C.) as amended, and as applicable to the time periods involved in this case, unless otherwise indicated.

The Government simply cannot have it both ways. The Government cannot argue that the Code should be strictly construed with regard to the assessment procedure and the extension of the statute of limitations for an additional six years under Section 6502 and then argue that Section 6303(a) with its equally precise language be ignored with regard to providing notice of the assessment to "each person liable for the tax."

B. The statute of limitations issue is secondary to the requirement of notice.

The issue with regard to the statute of limitations under Section 6501 and 6502 is secondary to the notice requirement of Section 6303(a). It is only pursuant to Section 6303(a) that notice is required to be given by the Government to "each person liable for the tax." If one accepts the argument of the Government that no notice is required to be given to any person liable for the tax, whether it be the employer, or the lender, then the statute of limitations question does not arise. Under this theory suit may be commenced within three years of when the tax return is filed or alternately if an assessment is made during such period the statute of limitations is extended for another six years under Section 6502. (See Res. Br. at 42-43). The net effect of this position advocated by the Government, is to eliminate Section 6303(a) from the Code.

If one accepts, however, the argument adopted by the Seventh, Eighth and Eleventh Circuits that the notice provision of Section 6303(a) must be complied with when the Government seeks to impose derivative liability on a lender under Section 3505, then the failure of the Government to provide such notice within 60 days after assessment con-

stitutes a defect in compliance with the statutory requirements imposed for collection of the tax from lenders.

As noted by the district court in the instant case:

> "The IRS takes the position that requiring the IRS to notify potentially liable third parties will undermine the purpose of § 3503(b) [sic] under which Congress intended to create an additional source for the recovery of unpaid withholding taxes. But as pointed out by the Bank, 26 U.S.C. § 6501(a) provides that the Government has three years from the time that a tax return is filed to impose an assessment." (Pet. App. 34a-35a).

Once the assessment has been made then notice must be provided. The key element, however, as was addressed in the district court opinion is the making of the assessment, which when done within the three year period of Section 6501, triggers the notice provision of Section 6303(a) and also extends the statute of limitations for another six years pursuant to Section 6502.

Without receiving any notice of assessment, the lender is a person liable for the tax under Section 3505 but receives less procedural protection than the employer who is primarily liable for the tax and who does receive notice of the assessment. The basic question is who is more in need of notice: the employer who fails to pay the tax and receives notice within 60 days of assessment, or the lender who is held derivatively liable for the tax up to nine years later and who presently receives no notice from the Government until suit is filed against him for the taxes?[2]

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[2]The Government suggests that the lender in all loans could have employer borrowers execute a power of attorney (IRS

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II. NOTICE TO A LENDER SERVES A USEFUL PURPOSE.

A. Notice of a tax assessment is relevant to a third party lender.

The Government argues that notice of the assessment to the lender is irrelevant and would provide no useful purpose. (Res. Br. 32-43). This contention has been rebutted both by Judge Weis in his dissenting opinion in the Third Circuit in the instant case (Pet. App. 23a) and more recently by the Eighth Circuit in *United States v. Messina Builders and Contractors Co.*, 801 F.2d 1029, No. 85-2505 (8th Cir. Sept. 23, 1986).[3]

The Eighth Circuit in disagreeing with the majority opinion of the Third Circuit in the instant case noted:

> "A party receiving 6303(a) notice learns two things: that the government is seeking payment of delinquent taxes, and the amount of those delinquent taxes. The third party presumably will know that the

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Form 2848) or a tax information form (IRS Form 2848-D) which would direct the IRS to mail copies of all tax notices to the lender. (Res. Br. 37-38 n. 13). Such an argument would shift the statutory obligation of the Government under § 6303(a) to the lender. In addition, if one accepts the Government's contention that § 3505 liability arises in only one out of 5,000 withholding tax delinquency cases (Res. Br. 17), such a suggestion would hardly appear to aid the Government in the orderly administration of the tax code by requiring that copies of all tax notices of all employer borrowers be sent to lenders regardless of whether a delinquency existed that involved a § 3505 liability.

[3]The Government has cited this case in its brief as a slip opinion. The full text of this recent authority which has not been previously filed with the Court is attached hereto in the appendix to this brief.

> employer is the source of the liability and thus has the opportunity to contact the employer and attempt to correct the situation, or at least, to stop advancing sums to the employer and thus lessen the total amount of liability. The notice provided to a third party, notifying him that the employer is delinquent and that the IRS is demanding payment for the amount the employer owes, thus serves an important function. To minimize the possibility that a third party will misinterpret the notice as a demand that the third party immediately pay a larger sum than he may owe, it would not be overly burdensome to the IRS to amend the notice to include explanatory information relating to the legal status of the third-party lender." (App. 9a).

The Government argues that the liability of the lender for the employer's taxes is only speculative in nature and "because the lender's liability in practical terms is highly contingent at the time the Section 6303(a) notice is mailed to the employer, it is difficult to describe the lender at that moment as a 'person liable' for the unpaid tax." (Res. Br. 17).

This argument completely obviates the legal consideration, however, whether the lender is or is not liable for the tax. The legal liability of the lender for the tax is fixed at the moment that funds are supplied to the employer in a manner which violates the statutory proscriptions of Section 3505. It is only the proof of such liability for the tax which remains to be shown by the Government. If the lender is liable for the tax, a conclusion which the Government plainly believes by virtue of having instituted the suit to collect the derivative tax, then the issue of the lender's liability "in practical terms" or as a speculative consideration evaporates and notice is required to be given to the lender under the provisions of Section 6303(a).

B. Lenders are prejudiced by receiving no notice of the assessment.

The Government attempts to counter the petitioner's argument that the lender is not prejudiced by not receiving notice of the assessment and facing the risk of suit nine years after the employer's tax return was filed because "a third-party lender will run a risk of Section 3505 liability only if it has actual knowledge that the employer's withholding taxes are not being paid . . . Lenders who engage in net payroll financing are accordingly on notice to take whatever steps they deem necessary to protect evidence and otherwise preserve their defenses for a period of nine years from the date on which the withholding taxes were due." (Res. Br. 37).

This is precisely the problem. Lenders are supposedly "on notice" but yet they receive no notice. The above argument also fails to take into account the definition of the term "actual notice or knowledge" contained in the Internal Revenue Code. As the Eighth Circuit in *Messina*, *supra*, noted:

> "The definition of 'actual' knowledge in section 3505 is so broad, however, as to create liability even with no actual knowledge. The Ninth Circuit in *Hunter* admitted that 'we agree that this statutory scheme does not wholly negate the possibility of prejudice to the lender * * *.' *Hunter* at 1441. Section 3505(b) requires the lender to have 'actual notice or knowledge (within the meaning of section 6323(i)(1))' that the employer did not intend to or could not pay the taxes. Code section 6323(i)(1) provides that an organization is deemed to have actual notice of a fact that would have been brought to its attention had it exercised due diligence. Thus, a lender who has no actual knowledge of the employer's failure to pay the tax but who has failed to exercise due diligence is nonetheless subject to section 3505(b) liability." (App. 10a).

A lender can therefore be held liable for the tax with actual notice or knowledge being imputed to him as defined in the Code but which in reality can mean a failure to exercise due diligence. In such a context it is clear that a lender is prejudiced in a practical as well as a legal manner by receiving no notice of the assessment as required by Section 6303(a).

C. Responsible officers are entitled to notice under Section 6672 of the Code.

The Government in its responsive brief notes that "responsible officers" who are liable for taxes under Section 6672 do not receive notice of the assessment against the employer under Section 6303(a). (Res. Br. 18 n.4).

Such an argument, however, ignores the fact that responsible officers under Section 6672(b) are required to be given a 30 day notice of the tax which the Government is seeking to collect from them before any levy or proceeding in court can be instituted by the Government.[4]

In addition, the responsible officers of a corporation as a practical matter will have previously been aware of the fact that the employer has filed a tax return which

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[4]IRS Form 2751 notifies the responsible officer of the "Proposed Assessment of 100 Percent Penalty" under Section 6672 and is accompanied by a collection letter notifying the individual of the proposed assessment. cf: M. Saltzman, *IRS Practice and Procedure* § 17.10 at 17.44 *et seq.* (1981); R. Schriebman, *IRS Tax Collection Procedures* § 731 at 226-227; § 786-88 at 243-246 (1985).

indicates the amount of the tax due but which does not remit to the Government funds for payment of such taxes. Therefore, responsible officers under Section 6672 will have actual notice of the employer's failure to pay the tax and will also receive statutory notice under Section 6672 of the intention of the Government to seek collection of the taxes from them.

In addition, the notice requirement of Section 6303(a) states that the notice requirement is only applicable: "Where it is not otherwise provided by this title . . ." Under Section 6672 a separate notice of taxes sought to be collected is provided to the responsible officers and therefore the notice requirement of Section 6303(a) does not come into effect.

III. NO COMMON LAW RIGHT FOR COLLECTION OF THE TAX EXISTS THAT IS INDEPENDENT OF THE STATUTORY REQUIREMENTS OF THE CODE.

The Government argues that it has a common law right to institute suit to collect the tax that is independent of the statute. The position of the Government fundamentally misconceives the relationship between the tax statute and the right to sue to collect the tax. As the Government admits: "There is no question that liability under Section 3505 is a creature of statute, but so are tax liabilities generally; and there is no doubt that the Government has a common law right to sue to collect taxes." (Res. Br. 29 n.10). The Eighth Circuit in its opinion in *Messina*, *supra*, addressed this argument in detail citing from the decision of the Eleventh Circuit in *United States v. Merchants National Bank of Mobile*, 772 F.2d 1522 (11th Cir. 1985) (*per curiam*); petition for *cert.* pending, No. 85-1480. The Eighth Circuit noted:

> "The government argues that it has a common-law right, existing independently of any statute, to sue on a debt. The government points out that no statute makes a suit by the United States to collect tax dependent on notice and demand, and thus a failure to assess or give notice will not bar a suit. This argument, however, ignores the fact that section 3505 creates a derivative liability, nonexistent at common law. As the Eleventh Circuit stated in *Merchants*:
>
> 'The United States also argues that even if § 6303(a) requires notice to third-parties such as MNB, the failure to give notice does not preclude suit to collect on MNB's alleged § 3505 liability. The United States contends that it has an inherent common law right to sue to collect debts which is entirely independent of the assessment process. Appellant, however, ignores the fact that third-party derivative liability of the sort set forth in § 3505 is a creature of statutory, not common, law. This argument is therefore untenable.'
>
> *Merchants* at 1524 n.1.
>
> We thus reject the government's attempt to recharacterize the third-party liability imposed by section 3505." (App. 11a).

In order to sue to collect the tax which is being imposed derivatively on the lender under Section 3505, the Government must of necessity comply with all statutory requirements of the Code for imposition of the tax, including the notice requirement of Section 6303(a).[5]

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[5]If the Government were to prevail in its argument that it had a common law right to sue for the tax independent of any requirements of the Code, then the Government could likewise ignore Section 6501 requiring it to bring suit within three years or file an assessment to extend the period to recover the tax by levy or proceeding in court for another six years under Section 6502.

CONCLUSION

For the foregoing reasons, the petitioner, Jersey Shore State Bank, respectfully prays that this Court reverse the judgment of the court of appeals and order reinstatement of the judgment of the district court.

Respectfully submitted,

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November 12, 1986

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 85-2505

United States of America	*	
Appellant,	*	Appeal from the United
v.	*	States District Court for
Messina Builders and	*	the Western District of
Contractors Co., and	*	Missouri.
Mike Messina,	*	
Appellees.	*	

Submitted: June 11, 1986

Filed: September 23, 1986

Before JOHN R. GIBSON, MAGILL, and FAIRCHILD,* Circuit Judges.

MAGILL, Circuit Judge.

This appeal concerns whether the Internal Revenue Service ("IRS") must notify a third party, who provides the wages an employer pays its employees, of the employer's tax deficiency on those wages. For the reasons discussed below, we affirm the judgment of the district court[1] that notice is required to a third-party provider.

(p. 2) I. PERTINENT STATUTES.

At the heart of this dispute are Internal Revenue Code ("Code") sections 3505 and 6303, 26 U.S.C. §§ 3505, 6303.

*HON. THOMAS E. FAIRCHILD, United States Senior Circuit Judge for the Seventh Circuit, sitting by designation.

[1]The Honorable D. Brook Bartlett, United States District Judge for the Western District of Missouri.

Section 3505(a) creates tax liability in a third party who pays wages directly to an employer's employees, and section 3505(b) creates tax liability in a third party who, knowing that the employer will not or cannot pay its employees' withholding taxes, nonetheless supplies wages to the employer.[2]

(p. 3) Section 6303 provides in pertinent part:

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[2]Section 3505 provides in pertinent part:

§ 3505. Liability of third parties paying or providing for wages.

(a) Direct payment by third parties

[I]f a lender, surety, or other person, who is not an employer * * * with respect to an employee or group of employees, pays wages directly to such an employee or group of employees, * * * such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes * * * required to be deducted and withheld from such wages by such employer.

(b) Personal liability where funds are supplied

If a lender, surely, or other person supplies funds to or for the account of an employer for the specific purpose of paying wages of the employees of such employer, with actual notice or knowledge (within the meaning of section 6323(i)(1)) that such employer does not intend to or will not be able to make timely payment * * * of tax required * * * to be deducted and withheld * * *, such lender, surety, or other person shall be liable in his own person and estate to the United States * * *. However, the liability of such lender, surety, or other person shall be limited to an amount equal to 25 percent of the amount so supplied * * *.

(c) Effect of payment

Any amounts paid to the United States pursuant to this section shall be credited against the liability of the employer.

§ 6303. Notice and demand for tax

(a) General rule

Where it is not otherwise provided by this title, the Secretary shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof.

Two other Code sections are integral to this issue. 26 U.S.C. § 6501, entitled "Limitations on assessment and collection," provides in pertinent part that: "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed * * * and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period." 26 U.S.C. § 6502 provides in pertinent part:

§ 6502. Collection after assessment

(a) Length of period

Where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun—

(1) within 6 years after the assessment of the tax * * *.

Thus, making an assessment within the three-year time limit prescribed by section 6501 permits collection efforts up to six years after assessment, or a total of nine years after a return is filed.

II. BACKGROUND.

In December of 1981, Messina Builders and Contractors (p. 4) Company, Inc. ("Messina"), a Missouri corporation engaged in general contracting and remodeling,

entered into two subcontracts for the City of Kansas City, Missouri, with Dummie, Inc. ("Dummie"), a Missouri corporation owned by Charles E. Edwards ("Edwards"). Edwards also owned C&C Plumbing Company, Inc. ("C&C"), whose employees performed the work on the two subcontracts. After six months Dummie was financially unable to continue, and Messina finished the project. Edwards filed tax returns and amended returns with the IRS for the second and third quarters of 1982, reporting taxes due on the wages paid to C&C employees for their work on the project. No payment was made, however, with any of these returns.

The IRS made assessments and gave C&C notice and demand for payment of the taxes, plus interest and penalties for a total of $13,235.22. Then, more than sixty days after having made assessments against C&C, the IRS demanded payment from Messina pursuant to section 3505(b), alleging that Messina had supplied funds to Dummie to pay the C&C employees performing the work. Messina denied the allegations and defended on the ground, inter alia, that the time limit of section 6303 had expired. The district court granted summary judgment for Messina and the United States brought this appeal.

III. SCOPE AND STANDARD OF REVIEW.

The parties agreed in the district court that the sole issue for determination was whether the notice provision of section 6303 is a condition to the liability imposed by section 3505(b). Accordingly, we limit our review to that issue. *Rogers v. Masem*, 788 F.2d 1288, 1292 (8th Cir. 1986).

When reviewing an appeal from a district court's grant of a motion for summary judgment, we apply the same standard as the district court was to have applied. *Elbe v. Yankton Indep.* (p. 5) *School Dist. No. 1*, 714 F.2d 848, 850 (8th Cir. 1983). We must view all facts and reasonable inferences drawn from the facts in the light most favorable to the party opposing the motion. *Kresse v. Home Ins. Co.*, 765 F.2d 753, 754 (8th Cir. 1985). Summary judgment may be granted only when there is no genuine issue of material fact and the moving party has proved he is entitled to judgment as a matter of law. *Id. See also* Fed. R. Civ. P. 56(c).

IV. DISCUSSION.

This issue has left the courts of appeals in disarray. The Seventh and Eleventh Circuits hold that section 6303 requires notice to a third-party lender,[3] *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983); *United States v. Merchants Nat. Bank of Mobile*, 772 F.2d 1522 (11th Cir. 1985),[4] while the Third and Ninth Circuits hold that notice to a third-party lender is not required. *United States v. Jersey Shore State Bank*, 781 F.2d 974 (3d Cir. 1986), *cert. granted*, 54 U.S.L.W. 3793 (U.S. June 2, 1986) (No. 85-1736); *United States v. Hunter Engineers & Constructors, Inc.*, 789 F.2d 1436 (9th Cir. 1986). We believe the Seventh and Eleventh Circuits espouse the better view, requiring notice to a third party.

The government advances substantially the same arguments set out in *Associates*, *Merchants*, *Jersey Shore*, and *Hunter*; in short, (1) that notice protection is only neces-

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[3]Our use of the word "lender" is not intended to limit the applicability only to lenders. We use it instead as a convenient way to refer to all persons who may be subject to section 3505 liability.

[4]The Eleventh Circuit in *Merchants*, in a short per curiam opinion, simply "agree[d] with the Seventh Circuit's reading of the applicable statutory provisions * * *." *Merchants* at 1524.

sary for tax collection by levy, not by suit; (2) that notice to a third party is in- (p. 6) appropriate and unnecessary; (3) that the government's right to sue for taxes, without notice and demand, is a common-law right independent of statute; (4) that requiring notice to a third party would greatly hinder the tax collection efforts of the IRS; and (5) that any prior changes in the Code did not expand the notice requirement.

Although many aspects of these arguments are persuasive and the equities are far from one-sided, these considerations must bow to the plain language and meaning of the statute, which specifies that "each person liable" for the tax must receive notice. As Judge Weis aptly stated, dissenting in *Jersey Shore:*

> The IRS wishes us to redraft that section so that it requires notice only to those individuals against whom taxes have been assessed. The reasons offered for this revision have some logic and would possibly ease administrative burdens on the government, but the arguments are directed to the wrong forum. They should be presented to Congress, not the courts.

Jersey Shore at 983-84 (Weis, J., dissenting).

A. Plain language.

In *American Tobacco Co. v. Patterson*, 456 U.S. 63, 68 (1982), the Supreme Court stated:

> As in all cases involving statutory construction, "our starting point must be the language employed by Congress," *Reiter v. Sonotone Corp.*, 442 U.S. 330, 337 (1979), and we assume "that the legislative purpose is expressed by the ordinary meaning of the words used." *Richards v. United States*, 369 U.S. 1, 9 (1962). Thus "[a]bsent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive." *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980).

The language in the statutes under discussion is abundantly clear. Section 3505 establishes that third parties may be liable (p. 7) for an employer's tax. The title of section 3505 reads: "*Liability* of third parties paying or providing for wages" (emphasis added). Both subsections (a) and (b) provide that "such [third-party] lender, surety, or other person *shall be liable* * * * to the United States" for the delinquent taxes (emphasis added). The conclusion appears inescapable that section 6303(a), when it speaks of "each person liable," includes the third-party lender. Like the Seventh Circuit in *Associates*, we conclude that Congress in section 3505 "established a nexus between the taxpayer's obligation and the lender's liability," *Associates* at 1097, and that the same limitations period should apply to both, for the requirement of notice to "each person liable for the unpaid tax" is clear in requiring notice to the third party.

B. Administrative proceeding v. lawsuit.

The government argues that notice is only necessary for administrative collections such as levy or distraint, where the government may proceed summarily, and that where the government must proceed by lawsuit, as with section 3505, service of the complaint provides adequate notice. The *Jersey Shore* court also distinguished between tax collection by administrative process and tax collection by lawsuit, pointing out that "the predecessor statute to section 6303(a) explicitly applied only to the collection efforts of the tax Collector, who by statute was authorized to collect taxes solely by administrative means, such as levying

on the taxpayer's property. I.R.C. § 3655 (1952)." *Jersey Shore* at 979.

We disagree. The plain language of section 6303(a) does not support the position set forth in *Jersey Shore* and argued by the government. The *Associates* court stated that:

> Section 6303(a) itself does not indicate that the right to notice is dependent on which tax collection option the government uses. * * * Section 6303(a) requires (p. 8) notice of the assessment of unpaid taxes in order to protect the person liable for paying the taxes, * * * and this rationale applies regardless of which collection mechanism is used.

Associates at 1100.

Our interpretation finds support in the mechanics of sections 3505 and 6303. Without notice, a third party could wait up to nine years after the employer files a return to learn of his potential liability. As Judge Will stated in the district court in *Associates*, "[t]he possibility of prejudice is obvious. Records and personnel may no longer be available. The opportunity to mitigate by making voluntary payments is lost. Interest mounts. The possibility of recovering from the borrower-employer diminishes. All of these would be obviated by notice." *Associates*, 548 F.Supp. 171, 174 (N.D. Ill. 1982).

C. Applicability to third-party lender.

The government, following the reasoning of the Third Circuit in *Jersey Shore*, argues that section 6303(a) was not intended to apply to a third-party lender. The *Jersey Shore* court noted that "a section 6303(a) notice consists of two discrete elements: (i) notice of the amount that has

been assessed and (ii) a *demand* that the individual receiving the notice *presently* satisfy that assessment." *Jersey Shore* at 978 (emphasis in original). The *Jersey Shore* court noted that the amounts of the employer's and the lender's tax liability will probably differ because the lender is not liable for the employer's portion of payroll taxes and because section 3505(b) limits lender liability to twenty-five percent of its loan. The court reasoned that notifying the third party of the employer's liability would be misleading and inappropriate. The court also noted that section 6303(a) does not demand payment from the third-party lender; rather, the government seeks at that time to collect only from the employer. The court was persuaded by these factors that Congress (p. 9) did not intend third-party lenders to receive notice of assessment.

We disagree, finding an alternative interpretation equally plausible. A party receiving 6303(a) notice learns two things: that the government is seeking payment of delinquent taxes, and the amount of those delinquent taxes. The third party presumably will know that the employer is the source of the liability and thus has the opportunity to contact the employer and attempt to correct the situation, or at least, to stop advancing sums to the employer and thus lessen the total amount of liability. The notice provided to a third party, notifying him that the employer is delinquent and that the IRS is demanding payment for the amount the employer owes, thus serves an important function. To minimize the possibility that a third party will misinterpret the notice as a demand that the third party immediately pay a larger sum than he may owe, it would not be overly burdensome for the IRS to amend the notice to include explanatory information relating to the legal status of the third-party lender.

D. Requirement of knowledge by third party.

The government next argues that because section 3505 requires a third party to have knowledge of the employer's financial state, the possibility for prejudice to the third party is nonexistent and additional notice would "serve no useful purpose." As the *Jersey Shore* court stated, "section 3505 liability only arises if the third party * * * is * * * actually or constructively aware of its *potential* liability for the taxes required to be deducted and withheld." *Jersey Shore* at 982 (emphasis in original).

The definition of "actual" knowledge in section 3505 is so broad, however, as to create liability even with no actual knowledge. The Ninth Circuit in *Hunter* admitted that "we agree that (p. 10) this statutory scheme does not wholly negate the possibility of prejudice to the lender * * *." *Hunter* at 1441. Section 3505(b) requires the lender to have "actual notice or knowledge (within the meaning of section 6323(i)(1))" that the employer did not intend to or could not pay the taxes. Code section 6323(i)(1) provides that an organization is deemed to have actual notice of a fact that would have been brought to its attention had it exercised due diligence. Thus, a lender who has no actual knowledge of the employer's failure to pay the tax but who has failed to exercise due diligence is nonetheless subject to section 3505(b) liability.

Alternatively, as Judge Will pointed out in the district court in *Associates*, "the mere fact that a lender is aware * * * that the government has filed a claim for unpaid withholding taxes is hardly notice to the lender that the government will seek to hold it liable under section 3505(b) * * *." *Associates*, 548 F.Supp. at 174-75. Notice is therefore necessary to lenders regardless of their actual knowledge of the employer's liability. As Messina points out, even assuming the lender knows of his potential liability

under section 3505(b), the government still must provide notice upon assessment for the same reason that the government, upon making an assessment against a taxpayer who has filed a return but who has failed to pay in full, must still give notice to the taxpayer even though he is aware of his tax liability.

E. Government's common-law right to sue.

The government argues that it has a common-law right, existing independently of any statute, to sue on a debt. The government points out that no statute makes a suit by the United States to collect tax dependent on notice and demand, and thus a failure to assess or give notice will not bar a suit. This argument, however, ignores the fact that section 3505 creates a (p. 11) derivative liability, nonexistent at common law. As the Eleventh Circuit stated in *Merchants:*

> The United States also argues that even if §6303(a) requires notice to third-parties such as MNB, the failure to give notice does not preclude suit to collect on MNB's alleged §3505 liability. The United States contends that it has an inherent common law right to sue to collect debts which is entirely independent of the assessment process. Appellant, however, ignores the fact that third-party derivative liability of the sort set forth in §3505 is a creature of statutory, not common, law. This argument is therefore untenable.

Merchants at 1524 n.1.

We thus reject the government's attempt to recharacterize the third-party liability imposed by section 3505.

F. Administrative burden.

The government next argues that the increased administrative burden imposed by third-party notice "would of-

fectively render section 3505 a dead letter." The *Associates* court called a similar claim "highly speculative and unsupported by any convincing statistics." *Associates* at 1099. The *Jersey Shore* court disagreed, stating that "in light of the manner such taxes are collected, available statistics and common sense both dictate that such a requirement would impose a prohibitory investigative burden on the government." *Jersey Shore* at 983. Although we recognize that a third-party notice requirement imposes an increased burden upon the IRS, this burden is not an unreasonable one. The IRS could modify its forms, pursuant to Code section 6011(a), to obtain information from the employer identifying any third-party lenders. Lenders listed on these returns could then be given a "protective" notice and demand, notifying them of their potential liability and demanding payment only if their loans violate section 3505. The IRS could also make separate (p. 12) assessments of the lenders' section 3505(b) liability.[5] Because section 6501 allows a separate assessment to be made within three years from the time the employer's return is filed, this would give the IRS reasonable time to proceed.

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[5]We disagree with the Ninth Circuit's holding in *United States v. Dixieline Financial, Inc.*, 594 F.2d 1311, 1312 (9th Cir. 1979), that because the assessment against the employer represents "the amount of the only sum in question," thus "independent assessment [against the third party] would accomplish nothing." As the Third Circuit acknowledged in *Jersey Shore*, the amount of the lender's liability will probably differ from the amount of the employer's liability, because of "both the differences between the taxes for which the employer and third party are liable and the limitations on liability contained within section 3505 itself." *Jersey Shore* at 978. Thus an independent assessment of the lender's liability has substantial informative value, and would allow the IRS to give the lender timely notice of that assessment and thereby maintain a section 3505 (b) action.

The IRS could, alternatively, make a supplemental assessment pursuant to Code section 6204(a), which permits a supplemental assessment "whenever it is ascertained that any assessment is imperfect or incomplete in any material respect."

By using either a separate or a supplemental assessment, the IRS could first quickly assess the employer, thereby avoiding a delay that "would seriously jeopardize the government's interest in collecting the taxes from the employer, because such a practice would enable other creditors to obtain prior liens against the employer's property." *Jersey Shore* at 983. The IRS would then have three years in which to investigate the employer and file a separate or supplemental assessment, then provide notice to the third party. This result would give the IRS time to conduct a full investigation while shortening the time the third party is unaware of its potential liability from nine years to a more equitable three years.

(p. 13) G. Legislative history.

We next address the government's interpretation of the legislative history. The government points out that although the predecessor to section 6303(a) was revised to become section 6303(a) in the 1954 Code, the Committee Reports stated that section 6303 "contains two changes from existing law," neither of which is pertinent to the issue of notice to a third party. H.R. Rep. No. 1337, 83d Cong., 2d Sess. A405-06, *reprinted in* 1954 U.S. Code Cong. & Ad. News 4017, 4553; S. Rep. No. 1622, 83d Cong., 2d Sess. 574, *reprinted in* 1954 U.S. Code Cong. & Ad. News 4621, 5222-23. The government concludes from this that because the predecessor to section 6303(a) required notice

only to an assessed party, therefore section 6303(a) also requires notice only to an assessed party, *i.e.*, the employer. We declined to accept this somewhat scant legislative history as dispositive. First, section 3505 did not exist when section 6303(a) assumed its present form, so it is fruitless to speculate as to whether section 6303(a) was intended to apply to section 3505. Second, contrary to the government's assertion, it is unclear whether the predecessor to section 6303(a) would have required notice only to an employer in the context of a collection arising under section 3505.

We find, moreover, that the legislative history offers equal support for our position. The *Hunter* court noted that "[w]hile * * * statements [in the legislative history] are unequivocal and clearly indicate Congress' intent that lenders be liable within the ambit of section 3505(b), they do not indicate whether lenders are due the notice specified in section 6303(a)." *Hunter* at 1439. Unlike the *Hunter* court, we find that the plain language of section 6303(a) expresses the congressional intent that third-party lenders receive notice. Moreover, the absence of clear support in the legislative history for the government's position must be construed against the government. "[C]ongres- (p. 14) sional silence, no matter how 'clanging,' cannot override the words of the statute." *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 105 S.Ct. 3275, 3285 n.13 (1985). In sum, we find that the legislative history, which is inconclusive at best, falls far short of the showing required to overcome the plain language of the statutes under discussion.

For the foregoing reasons, we agree with the view held by the Seventh Circuit in *Associates*,[6] and followed by the Eleventh Circuit in *Merchants*, that the IRS must provide timely notice to a third-party lender when proceeding under section 3505(b).

FAIRCHILD, Senior Circuit Judge, dissenting.

Because I find the reasoning of *United States v. Jersey Shore State Bank*, 781 F.2d 974 (3rd Cir. 1986), *cert. granted*, 34 U.S.L.W. 3793 (U.S. June 2, 1986) (No. 85-1736) and *United States v. Hunter Engineers & Constructors, Inc.*, 789 F.2d 1436 (9th Cir. 1986) more persuasive, I must respectfully dissent.

(p. 15) I add only two observations concerning the language at issue:

(1) An assessment is a determination that one or more persons are liable for a tax. It seems a natural reading of § 6303(a) that "each person liable for the unpaid tax" means each person whose liability has been deter-

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[6]We note that the *Associates* court, in reaching its holding, followed what is perceived to be the Ninth Circuit's reasoning in *United States v. Dixieline Financial, Inc.*, 594 F.2d 1311 (9th Cir. 1979), that notice to a third-party lender is required. The Ninth Circuit subsequently clarified its position in *Hunter*, stating:

> Admittedly, our language can be interpreted to imply that notice to lenders is required. Indeed, courts have relied in substantial part on *Dixieline* to conclude that notice to lenders is required [citations omitted]. We believe that reliance was misplaced. * * * *Dixieline* does not alter our conclusion today that section 6303(a) does not require notice to third party lenders facing potential liability under section 3505.

Hunter at 1440. Our reading of *Associates* however, convinces us that its reasoning stands firm despite the loss of *Dixieline* to support its decision.

mined by the assessment referred to. The facts essential to liability of third-party providers are not determined by the assessment.

(2) Section 3505 does not, literally, make the third-party provider "liable for the unpaid tax," but "liable * * * in a sum equal to the taxes."

A true copy.

ATTEST:

CLERK, U.S. COURT OF APPEALS,
EIGHTH CIRCUIT.